Private investment is essential

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Introduction

2015: tough but growth expected to have bottomed out

- Significant improvement in composition of spending away from energy subsidies...
- ... allowing a spectacular rise in public investment...
- ... and helped growth in 2015

2016: staging a firm rebound will be no small challenge

- Given pressures on export and oil and gas fiscal revenues, private investment recovery is essential

Private investment also critical to address medium-term challenges

- Revival of manufacturing, rise of tourism
- Good quality jobs
How public investment helped growth

Staging a firm growth rebound in 2016

Medium-term challenges and opportunities
The budget before 2015:
Close to 1/3 spent on energy subsidies

Share of average central government spending, 2012-2014, percent

Source: Ministry of Finance; World Bank staff calculations
Fuel subsidy reform: The foundation

Source: Ministry of Finance; World Bank staff calculations
Public investment and growth in 2015

Real growth yoy, percent

Note: Capital expenditure deflated with the implicit fixed investment deflator.
Source: BPS; Ministry of Finance; World Bank staff calculations
How public investment helped growth

Staging a firm growth rebound in 2016

Medium-term challenges and opportunities
Weak global growth and global trade: 
*Harder to generate export revenues*

![Graph showing annual growth of global trade and GDP]

Subdued household real income growth

Only moderate pick up in private consumption

Weaker job creation

GDP growth, percent, LHS; millions, RHS

Persistently high food price inflation, percent

Source: BPS; World Bank staff calculations
Low commodity prices

Continued pressure on oil and gas fiscal revenues

Contributions to nominal growth yoy, percent

Source: Ministry of Finance; World Bank staff calculations
Public investment rise in 2016

Likely less dramatic than in 2015

Budget allocation for infrastructure increases, driven by transfers to SNGs and SOEs (IDR trillion)

Source: Ministry of Finance; World Bank staff calculations
Private investment is essential

Real fixed investment growth

*(percent yoy)*

Note: Capital expenditure deflated with the implicit fixed investment deflator.
Source: BPS; Ministry of Finance; World Bank staff calculations
## Baseline outlook

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016f</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (annual % change)</td>
<td>4.8</td>
<td>5.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Consumer prices (annual % change)</td>
<td>6.4</td>
<td>4.0</td>
<td>4.6</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-2.1</td>
<td>-2.3</td>
<td>-2.5</td>
</tr>
<tr>
<td>Budget balance (% of GDP)</td>
<td>-2.5</td>
<td>-2.8</td>
<td>n.a.</td>
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Source: BPS; World Bank staff projections
Supporting near-term growth (1)

Gradual monetary easing

Annual growth, percent

- Investment lending rate
- JIBOR interbank rate - 3 month
- BI policy key rate

Source: BI; World Bank staff calculations
Revenue collection

*Ongoing reform areas critical*

- **Reforming tax policy:**
  - Revisions to Income Tax and VAT Laws and the Final Tax regime for MSMEs provide an opportunity to broaden the tax base and reduce economic distortions.

- **Strengthening tax administration:**
  - Ease electronic filing process for taxpayers, while making e-filing mandatory for certain types of taxes;
  - Unique taxpayer ID system;
  - Improved compliance risk management and auditing processes, including use of third-party data;
  - Stronger law enforcement efforts.

- **Building the underlying tax administration capacity:**
  - Investment in IT and data management systems.
Business environment

*Further reforms could tip investor confidence*

- Reducing or removing minimum capital and reserve requirements for setting up logistics service providers – too high and hinder competition

- Clarifying the roles of port authorities and port operators in port development and management – lack of clarity has led to severe underinvestment in port infrastructure

- **Regulatory review mechanism is needed** to take stock of existing business, investment and trade regulations (e.g. NTMs), cancel ones that are conflicting and unnecessary, and reject or approve new regulations

- Establishing an up-to-date, comprehensive depository of licensing/regulatory requirements that can be accessed online - there is no list of requirements that firms needs to comply with
How Public Investment Helped Growth

Staging a firm growth rebound in 2016

Medium-term challenges and opportunities
Manufacturing has prematurely retracted due to commodity boom

Manufacturing as percentage of GDP (y axis), GDP per capita (x axis), PPP (constant 2011 int USD)

Source: World Development Indicators, World Bank
Worker productivity is low despite wage advantage

**Real wages (real 2012 USD)**

- China
- Malaysia
- Philippines
- Thailand
- Vietnam

**Unit labor costs in manufacturing, 2012 = 100**

- Indonesia
- Malaysia
- Thailand
- Philippines
- Vietnam

Source: Calculation based on CEIC data
Sluggish manufacturing growth and low productivity have reduced the quality of jobs…

**Percent of workers in different types of work**

- Self-employed/employers in agriculture
- Unpaid family worker in agriculture
- Self-employed/employers in non agriculture
- Unpaid family worker in non agriculture
- Casual workers in agriculture
- Casual workers in non agriculture
- Domestic, security and cleaning workers
- Employees paid below Minimum Wage
- Employees paid at least the Minimum Wage

Source: World Bank calculations based on BPS, Sakernas data
Poor quality of jobs keeps many around the poverty line

- 75 percent of poor households fail to definitely move out of poverty or vulnerability over a three-year period.
- A large number of workers are not safe and secure from poverty due to their type of job.
- The quality of jobs in manufacturing is typically better – more formal and higher value.
- China lifted 680 million people between 1992 and 2012 by focusing on manufacturing growth.

Source: World Bank calculations based on BPS, Sakernas data.
Medium-term strategy: Identify promising industries (1)

Identify promising industries, “to avoid shooting in the dark”

Share to total exports, percent

Low-tech exports

- Industrial acid oils
- Wood furniture
- Palm oil prod (rhs)
- Footwears
- Textiles&garments
- Playwood (rhs)

Medium-Low-tech exports

- Gold
- Tin, not alloyed
- Rubber tires
- Petrol products (rhs)
- Refined copper

Source: UN-COMTRADE, HS4 digits and OECD industrial code
Medium-term strategy:
Identify promising industries (2)

Share to total exports, percent

Medium–high–tech exports

- Insulated cable fiber
- Cars
- Automotive spareparts
- Bulldozers, excav, & parts
- Parts of motorcycles
- Saturated monohydric alcohols

High–tech exports

- Office & comp equip
- Radio, TV & com equip
- Aerospace (RHS)
- Drug & medicine (RHS)

Source: UN-COMTRADE, HS4 digits and OECD industrial code
Medium-term strategy:

**Key reforms**

- Implement cross-cutting reforms to create an **supportive policy environment** for **all firms in all sectors**
- Progress on **labor laws and regulations dialogue and reform** crucial (e.g. severance pay creating a lose-lose outcome)
- Recognize that export growth and industrialization will be driven by a few industries: **policy focus and attention to most promising branches is key**
- For promising sectors:
  - Facilitate agglomeration/ clustering
  - Actively weed out entry barriers
  - Actively attract FDI and joint ventures in these industries
  - Public-private partnerships to close skills gaps (training, specific schools, etc.)
Beyond the 10 economic policy packages

- How to address constraints to growth in logistics, trade, investment climate and financial markets

Sustainable energy development

- Aligning pricing, regulations and investment policies can help Indonesia’s transition to a more sustainable energy path

Public support for action on inequality

- A majority of Indonesians think that inequality is too high and urge government action to reduce it